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GENERIC CERTIFICATES

by

Carl R. Zulauf
Assistant Professor
Department of Agricultural Economics and Rural Sociology
The Ohio State University

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GENERIC CERTIFICATES

Generic certificates have been used to make payments to farmers and others (first holders) under a variety of programs. They are issued for a specific dollar value, redeemable for any commodity, except peanuts and tobacco, under nonrecourse loan and/or government ownership or for cash after a specified date. Generic certificates are negotiable and can be sold to second, third, etc. holders. Buyers include farmers, merchants, and others. Their price is stated as a percent of face value and generally has exceeded 100%.

The price of generic certificates depends on the value of having immediate access to government-obligated commodities and the generic nature of the certificates. The latter refers to the fact that they can be redeemed for a variety of commodities, not just the commodity program originally issued under, and can be redeemed anywhere in the country, not just the county of original issuance. Crop farmers have been the major buyers and sellers of generic certificates so far. Thus, given the limitations of space, the following discussion will focus on the price of generic certificates for a crop farmer. The formula for this price is:

$$\frac{\text{Market Price} + \text{Government Price} - \text{Opportunity Price} +/- \text{Premiums/Discounts}}{\text{Posted Price}}$$

where Market Price = local cash price per bushel.

Government Price = price per bushel at which government or loan stocks acquired.

Opportunity Price = price per bushel at which grain would have been sold if generic certificates not available.

Discounts or premiums = characteristics unique to the particular generic certificate transaction, such as quality considerations, stated per bushel.

Posted Price = price per bushel posted daily by Commodity Credit Corporation for each county; converts dollar value of certificates to quantity equivalent.

Generally, posted and cash price will be the same. Premiums and discounts can be important for individual transactions, but in general will be minimal. The most common government price is the loan rate. The opportunity price varies by farmer, but can be broadly categorized into four types: (1) for producers who do not have storage space and must sell at harvest, this will be the harvest price; (2) for those who store under loan, but off the farm, it will be the loan rate minus the nine-month cost of storage (excluding interest); (3) for those who store under loan on the farm, it will be the loan rate minus what the producer wants to charge for on-farm storage (excluding interest), which generally is zero; (4) for those who believe the market price will exceed the loan rate, this price becomes the expected price minus storage costs (including interest).

To work through a few examples, assume the posted and cash prices are \$1.35, the loan rate is \$1.84, off-farm storage charge is .03/month, and on-farm storage will be charged the value zero. The price of the generic certificate is 136% ((1.35 + 1.84 - 1.35)/(1.35)) for situation (1); 120% ((1.35 + 1.84 -1.57)/(1.35)) for situation (2); 100% ((1.35 + 1.84 -1.84)/(1.35)) for situation (3); and less than 100% in situation (4) since the opportunity sales price exceeds \$1.84. What generic certificates basically offer crop farmers is a means to guarantee the full loan rate for the commodity sold.

The formula suggests that certificate values will decrease as the posted price increases and as the opportunity selling price increases. Both of these should vary with the normal seasonality of prices. There is one other important pricing factor, and that is the supply of certificates. Issuance of additional certificates seems likely. This will decrease the value of certificates because the supply has increased, assuming everything else equal. Therefore, marketing generic certificates is like marketing any other commodity. Farmers need to carefully weigh all factors in making the marketing decision.